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Is Music the Next eBooks? An Antitrust Analysis of Apple's Conduct in the Music Industry

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Over the last twenty years, two waves of technological change have transformed the way people purchase and listen to music. First, digital downloads displaced physical sales of albums. More recently, digital downloads, once the primary way to gain access to digital music, have come to be challenged by streaming services. Apple, a leader in the digital download market with iTunes, has engaged in various strategies to meet the challenge. This paper specifically focuses on two types of conduct – Apple's pressure on labels to enter into exclusive license agreements, also known as windowing, and Apple's pressure on the market to abandon streaming options like Spotify's "freemium" service.

This paper conducts an antitrust analysis of windowing in the music industry and also examines the legality of eliminating the advertising-based "free" streaming model. The paper engages in an examination of Section 1 and Section 2 Sherman Act claims against Apple for these exclusionary acts based on parallel exclusion, joint refusal to deal, price maintenance, and monopoly maintenance theories. We believe of greatest concern is the potential elimination of the free advertising based model, which may be a per se violation of the antitrust laws.

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INTRODUCTION

At the severe risk of stating the obvious, the music industry has undergone significant changes over the last two decades.[1] We pick up the story in the 2010s,[2] at a point where Apple established a dominant and profitable presence in the downloading of digital music with its iTunes download store. Over the decade Apple has come to face a serious challenge by a new generation of "streamers" – companies like Pandora or Spotify who use different technologies and licensing strategies to offer unlimited music for a low monthly price.

As streaming companies like Spotify increased in popularity, Apple has met the challenge in increasingly aggressive ways. The question addressed by this paper is simple: at one point has or will conduct by Apple or the major music labels violate the American antitrust laws?

This paper examines just two types of conduct (without any claim to being comprehensive). The first is Apple's increasing practice of signing exclusive licenses with particular artists, to create windows in the music distribution world. The second is Apple's pressuring labels to ban "free" streaming options – that is, streaming to customers that is based on an ad-revenue model. We conclude that the first, if it remains limited in time and scope, may not have serious anticompetitive consequences; while the second raises serious questions of a *per se* violation of Section 1 of the Sherman Act.

1 David Brown, *Survival of the Fittest in the New Music Industry*, ROLLINGSTONES.COM (Nov. 8 2012), http://www.rollingstone.com/music/news/survival-of-the-fittest-in-the-new-music-industry-20121108
[2] For earlier parts of the story, see Tim Wu & Jack Goldsmith, Who Controls the Internet? Ch. 7 (2006).

Part 1: Background

A. The Landscape

As recently as the late 1990s, physical media, whether the compact disc or vinyl record, remained the way most Americans listened to music.[3] Nonetheless, particularly after the development of the MP3 music file, the fact that music could be easily and efficiently distributed online was obvious. The major labels, however, stuck to physical media, leading to the rise of uncompensated peer-to-peer file sharing, as offered by firms like Napster or Kazaa, which for a time threatened to become the norm.[4] Finally, in 2003, Apple and the major labels agreed to offer an online alternative to the peer-to-peer sites and launched the iTunes Music Store.[5] iTunes, the brainchild of Apple CEO Steve Jobs, was unique at the time – for the store provided a way for consumers to legally access digital music by purchasing and downloading albums and individual tracks, while also providing the industry with various protections against piracy.[6] iTunes proved popular, and as the file sharing programs went bankrupt after losing copyright litigation, it quickly grew dominant –[7] becoming the "sole king reigning over the digital music

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3 Jacob Ganz, *The Decade in Music: The Way We Listen Now,* NPR.ORG (Dec. 2 2009), http://www.npr.org/2009/12/02/121023882/the-decade-in-music-the-way-we-listen-now

4 Stephen Witt, *The Man Who Broke the Music* Business, NEWYORKER.COM (April 27 2015), http://www.newyorker.com/magazine/2015/04/27/the-man-who-broke-the-music-business; Richard Nieva, *Ashes to Ashes, Peer to Peer: An Oral Hisory of Napster,* FORTUNE.COM (Sept. 5 2013), http://fortune.com/2013/09/05/ashes-to-ashes-peer-to-peer-an-oral-history-of-napster/

5 APPLE LAUNCHES THE ITUNES MUSIC STORE, http://www.apple.com/pr/library/2003/04/28Apple-Launches-the-iTunes-Music-Store.html (last visited Feb. 13, 2015).

6 Id.

7 "Companies like Nielsen providing data and sales tools to music industry professionals for years have incorporated digital sales into their reports, as the industry grew to accept digital sales as a significant revenue source. In 2012, Billboard, the company for decades who has defined music hits with their song charts, started counting digital sales and online streams along with radio airplay, acknowledging that a stream on Spotify or a download on iTunes are all a meaningful part of the fan experience." See James McKinley Jr., *Changes To Charts By Billboard Draw Fire,* NYTIMES.COM (Oct. 26 2012), http://www.nytimes.com/2012/10/27/arts/music/billboards-chart-changes-draw-fire.html?pagewanted=all&_r=0.

realm"[8] and the "world's largest music store."[9] At its height, Apple owned about 75% of the digital music market.[10]

But, the landscape has changed. In a classic example of the Schumpeterian competition[11], Apple since the 2010s has begun to face its own innovative challengers. Namely, iTunes has faced increasingly intense challenge from various types of music "streaming" firms, including Spotify, Rdio, Rhapsody, Pandora, Google, and Tidal. The streamers come in two varieties (arising from a distinction in the Copyright Act 17 U.S.C.§ 115). Some, in the "Pandora" model, more or less replicate radio, allowing the user to choose a genre of music, but not the particular songs; the companies using this model rely on a compulsory license to gain access to the music. An alternate model allows the user to choose individual songs from a broad catalogue of music; companies following this model rely on licenses negotiated with the labels. Both models offer either advertising-supported options, or access based on a monthly payment.

The streamers offer several important distinctions and advantages as compared to Apple's iTunes. The first is a broader range of music – for a monthly fee (paid in dollars or ad-revenue), the streamers give access to an extensive catalog of music published. The second is the ability to access that catalogue from almost anywhere, sometimes even without an Internet connection. Finally, the streamers offer a way to get music for consumers who are unwilling to pay in a traditional sense but willing to listen to

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8 *The Music Industry: Beliebing in streaming,* THE ECONOMIST, *March 22, 2014.*

9 Ed Christman and Alex Pham, *Apple Press Labels For More 'Beyonce'-Type Exclusives in Wake of Downloads' Slide,* BILLBOARD.COM (Feb. 28, 2014, 2:22 PM), http://www.billboard.com/biz/articles/news/record-labels/5922966/apple-presses-labels-for-more-beyonce-…type-exclusives-in

10 Peter Kafka, *Apple Still Has Giant Advantage in Digital Music, With 75 Percent of the Market, http://allthingsd.com/20130620/apple-still-has-a-giant-advantage-in-digital-music-with-75-percent-of-the-market/*

11 Herbert J Hovenkamp, *Schumpeterian Competition and Antitrust*, University of Iowa Legal Studies Research Paper No. 08-43,October 1, 2008.

advertisements – the “freemium” model. Many consumers prefer streaming to purchasing individual albums or tracks, and it has reengaged an entire population of individuals who previously were reluctant to purchase music. Many see it as the future – as Billboard Editor-at-Large Joe Levy says “we are moving to a streaming economy.”[12]

As for the music labels, the streamers offer several important advantages. First, in economic terms, the streamers are technically selling a “bundle” of music; and bundling models, popularized in the pay-TV industry, can yield more revenue than individual, a la carte sales. Second, the labels understand the streamers as offering competition not just to Apple, but to piracy, which of course yields no revenue.

The industry data supports the shift toward streaming. Since the rise of the streamers, Apple has experienced significant declines in iTunes market share, reporting 63% of the market of digital downloads in 2013, down from 70% in 2010.[13] In January 2014, digital albums and tracks fell in sales for the first time since the iTunes store launched in 2003.[14] The entire industry experienced more than a 13% decease in downloads in the first quarter of 2014,[15] ending 2014 with a decline of 9% in paid

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12 Jim Farber, *Taylor Swift to Spotify: You Can't Stream '1989' Or Any of My Music,* NYDAILYNEWS.COM, (Nov. 3 2014), http://www.nydailynews.com/entertainment/music/taylor-swift-fights-spotify-article-1.1997766

13 Andy Fixmer, *Apple's 10 Year Old iTunes Loses Ground to Streaming,* BUSINESSWEEK.COM (Apr. 25 2013), http://www.businessweek.com/articles/2013-04-25/apples-10-year-old-itunes-loses-ground-to-streaming; see also http://www.computerworld.com/article/2518165/technology-law-regulation/apple-controls-70--of-u-s--music-download-biz.html. See also Ed Christman, *What's Behind the Digital Download's Decline and Can Streaming Save the Day?* BILLBOARD MAGAZINE (Jan. 18 2014), http://www.billboard.com/biz/articles/news/record-labels/5869521/whats-behind-the-digital-downloads-decline-and-can-streaming. This decline may be attributed to the fact that iTunes remains unavailable on Android operated mobile devices, while consumers are turning to mobile for music more frequently and the Android mobile operating system continues to grow in popularity. See Rolfe Winkler, *Google's Android Begins to Top Out,* WALLSTREETJOURNAL.COM (Nov. 2 2014), http://www.wsj.com/articles/googles-android-begins-to-top-out-1414972604

14 Ed Christman, *supra* Note 9.

15J.J. McCorvey, *Why Does Apple Need Beats? It's All About the Music,* FAST COMPANY, September 2014.

downloads of albums and 12% in paid songs.[16] It is the first time since the advent of digital sales that the format's declines resemble the now-routine annual percentage declines for the CD.[17] Meanwhile, the use of streaming increased in 2014 by 54%.[18] The music companies in their first quarter 2015 earnings reported substantial revenue from streaming. CEO of Warner Music Stephen Cooper announced in a recent earnings call that Warner generated more money from streaming than from digital downloads in the first quarter, and streaming revenue increased by over 33% while digital sales revenue increased by only 7%.[19] Vivendi and Universal Music Group also announced in their first quarter earnings that "growth in subscription and streaming revenues more than offset the decline in both digital download sales and physical sales."[20] And, in a recent presentation at the Music Biz Conference in Nashville, Will Page, Spotify's director of economics, revealed Spotify represented one out of every 10 dollars record labels earned in the first quarter of 2015.[21]

Despite the decline of downloads, Apple still maintains its position as a recognized leading distributor of digital music, particularly given the power of Apple's brand, its other products, lock-in strategies, and famous cash reserves. Yet, as suggested

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16 Ethan Smith, *supra* Note 11.

17 Ed Christman, *Nielson's Q1 Numbers: Sales Down, Streams Up,* BILLBOARD.COM (Ap. 7, 2014, 12:43 PM), http://www.billboard.com/biz/articles/news/legal-and-management/6041328/nielsens-q1-numbers-sales-down-streams-up. See also Ben Sisario, *Downloads in Decline as Streaming Music Soars* NYTIMES.COM (July 3, 2014), http://www.nytimes.com/2014/07/04/business/media/sharp-rise-seen-in-music-streaming-as-cd-sales-and-downloads-plummet.html?_r=0

18 Id.

19 Brad Reed, *A Win for Apple: Spotify Will Reportedly Severely Restrict Its Free Streaming* Tier, BGR.COM (May 15,2015), http://bgr.com/2015/05/15/apple-beats-music-vs-spotify-free-streaming/

20 Andrew Flanagan, *Universal Music Group and Vivendi See Revenue Up in First Quarter,* BILLBOARD.COM (May 12, 2015), https://www.billboard.com/articles/business/6561347/universal-music-group-and-vivendi-see-revenue-up-in-first-quarter

21 Glenn Peoples, *Spotify was 10 Percent of U.S. Label Revenue in First Quarter, says Will Page* BILLBOARD.COM (May 13, 2015), http://www.billboard.com/articles/business/6561447/spotify-ten-percent-label-revenue-first-quarter-2015-will-page

by the rise of streaming, Apple's market position has been threatened by changes in how consumers listen to music. Apple has reacted to the challenge presented by the streamers in several ways. First, Apple launched its iRadio service in June 2013,[22] which follows the Pandora model, but came to market nearly a decade after Pandora.[23] In 2014, Apple acquired, for $3.2 billion, Beats Electronics, which was portrayed as a– "bid to stay relevant in the music world."[24] And most recently, in 2015, Apple launched "Apple Music," an on-demand streamer at a $9.99 per-month price point, with a three-month free trial period, but no "freemium" ad-revenue model.[25] Apple Music, unlike Spotify's App, comes pre-installed on new Apple products. With the entire Apple ecosystem and integration capabilities that exist between iCloud and iTunes, Apple is in a position to create a serious threat to streaming rivals.[26]

One might ask why Apple, a company with over $100 billion in revenue and some of the largest profits in corporate history, would care about competition in the relatively small market for streaming music. iTunes is, of course, only one Apple product among many, and not even close to the most profitable. Many sources, however, describe dominance in music distribution as the "cornerstone of Apple's content strategy and key to facilitating Apple's larger business goals.[27] Eddy Cue, Apple's senior vice

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22 APPLE ANNOUNCES ITUNES RADIO, https://www.apple.com/pr/library/2013/06/10Apple-Announces-iTunes-Radio.html (last visited Jan. 7, 2015).

23 John Cionci, SPOTIFY BLOG (Jul. 14, 2011, 11:11 AM).

24 *J.J. McCurvey, supra* note *11*.

25 Nelson Granados, *Apple Music Launch: Too Bad Steve Jobs Is Not Around,* FORBES.COM COM (June 30, 2015), http://www.forbes.com/sites/nelsongranados/2015/06/30/apple-music-launch-too-bad-steve-jobs-is-not-around/

26 Tony Bradley, *3 Reasons Apple Streaming Music Will Be Serious Threat to Rival Services*, FORBES.COM COM (Feb. 5, 2015), http://www.forbes.com/sites/tonybradley/2015/02/05/3-reasons-apple-streaming-music-will-be-serious-threat-to-rival-services/2/

27 In a hearing on the Universal/EMI merger, former chairman of Warner Music Group speculates about the importance of music and iTunes in Apple's success, *see* Edgar Bronfman, *Testimony Presented To The Senate Committee on the Judiciary Subcommittee on Antitrust, Competition Policy and Consumer Rights*

president of Internet Software and Services says, "music is such an important part of Apple's DNA and always will be."[28] Music is strategically important to Apple because it helps keep users locked-in to Apple's highly profitable iPhone, iPad and computer products. Consider the fact that it can be harder or inconvenient for a user to switch, for example, to an Android phone made by Samsung when their music was already purchased from Apple and remains most easily accessible from an Apple device.[29] In contrast, a Spotify user can switch between different operating systems and still access the same music. Because music allows Apple to attract and retain customers throughout the hardware upgrade cycle, Apple is extremely eager to meet the competition from the streamers.[30]

In this paper, we consider two major ways in which Apple may attempt to damage the prospects of its streaming competitors; the description is not comprehensive.[31] First, Apple can seek, and has sought, in various ways, to restrict the supply of music to its streaming competitors. The most obvious is where Apple executives pressure labels to provide Apple with exclusives – that is, to exclusively launch their content first on Apple

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on the UMG/EMI Merger and Future of Online Music, at 6, n.#8 (June 21, 2012). *See also* Douglas A. McIntyre, *Why Apple is Now No.1 Company in the World*, NBCNEWS.COM (Aug. 10 2011 4:27 PM), http://www.nbcnews.com/id/44090899/ns/business-us_business/t/why-apple-now-no-company-world/;, Walter Isaac, STEVE JOBS (2013). See also supra Introduction.

28 Dale Eisinger, *Taylor Swift Dumps Spotify, Igniting Turf War Between Spotify and Apple,* THEDAILYBEAST.COM (Nov. 3 2014), http://www.thedailybeast.com/articles/2014/11/03/taylor-swift-dumps-spotify-igniting-turf-war-between-spotify-and-apple.html

29Ed Christman and Alex Pham, *supra,* note 3.

30 Eisinger, *supra*, note 27.

31 In particular, this paper does not address the use of Apple's iOS platform.

before making it available on other platforms.[32] This practice is sometimes referred to as “windowing.”[33]

As it stands, Apple has already struck various exclusive deals. Beyonce’s fifth studio album “Beyonce”, which launched in December 2013, was offered exclusively on iTunes for one week and became the fastest-selling album in the digital store.[34] Most recently, Apple and U2 struck up a deal for $100MM to launch U2’s new album initially exclusively on iTunes.[35] Taylor Swift also recently generated significant attention by removing her song catalog from streaming service Spotify in order to maximize sales on iTunes.[36] In November 2014, Taylor Swift’s label, Big Machine Label Group, a subsidiary of Universal Music Group (UMG), withdrew the entire Taylor Swift catalog from Spotify while keeping her music on other streaming services owned by Apple including Beats Music and iRadio.[37]

The question raised by the exclusives is whether they may reach a point where Apple is in a position to maintain its dominance by foreclosing competition in the

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32 Dawn C. Chmielewski and Randy Lewis, *Apple is asking record labels for exclusive iTunes releases,* LATIMES.com (Mar. 10, 2014 4:35 PM), http://touch.latimes.com/#section/-1/article/p2p-79582333/; Ed Christman and Alex Pham, *supra* note 3.

33 Windowing is defined as the act of holding back a new release from other digital services. It is the practice of staggering a title's release-date so consumers have access at different times on different services. See Glenn People, *Exclusive: Windowing Hurts Sales, Increases Piracy, Says Paper Released by* Spotify, BILLBOARD.COM (Jul. 17, 2013 11:48 AM), http://www.billboard.com/biz/articles/news/digital-and-mobile/2032983/exclusive-windowing-hurts-sales-increases-piracy-says.

34 Dawn C. Chmielewski and Randy Lewis, *Apple is asking record labels for exclusive iTunes releases,* LATIMES.com (Mar. 10, 2014 4:35 PM), http://touch.latimes.com/#section/-1/article/p2p-79582333/; Ed Christman and Alex Pham, *supra* note 3.

35 Nathan Ingraham, *U2 Releases its new album for free today exclusively on iTunes,* THEVERGE.COM (Sep. 9, 2014 2:56 PM), http://www.theverge.com/2014/9/9/6126711/u2-releases-its-new-album-for-free-today-exclusively-on-itunes.

36 Jim Farber, *supra* note 17

37 Hannah Karp and Sven Grundberg, *Taylor Swift Pulls Her Music From Spotify*, THEWALLSTREETJOURNAL.COM (Nov. 4, 2014 12:25 AM), http://online.wsj.com/articles/spotify-says-taylor-swift-pulls-her-music-from-service-1415035751?tesla=y&ref=/home-page.

industry.[38] If certain content is only available on iTunes, other services may experience a decline in users and ultimately be forced out of business.

Second, Apple could attempt to weaken competitors by pressuring labels to ban their “free” options.[39] Products like Spotify’s “freemium” (ad-supported) tier pose a real challenge to Apple as it launches its own streaming service. As a result, Apple has reportedly placed pressure on the music labels to refuse to sell content to streaming companies who then make the music available on an ad-revenue basis.[40] That is, Apple could attempt to force its competitors to abandon an entire business model (ad-share revenue) in order to maintain the dominance of downloads and aid its own version of streaming. Given that Apple remains the dominant seller of music, the successful elimination of a business model relied on by competitors would have clear consequences for competition in the industry.

This paper engages in the first in-depth analysis of the antitrust implications of windowing and ad-revenue bans in the music industry. As in any antitrust analysis, the challenge is distinguishing legitimate methods of competition from anticompetitive conduct. This paper argues that Apple’s exclusives and weakening of competitors’ business models in the music industry may have anticompetitive effects depending on the terms of the agreements and the parties involved. Pressuring labels to ban ad-revenue poses even more serious questions as a potential per se violation of Section 1 of the Sherman Act.

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38 This paper acknowledges that not all effects on the industry from exclusive agreements are negative. From the rights holder perspective, windowing could provide labels and artists with a bargaining power tool to get a streaming compensation model that they believe is more aligned with what they deserve.

39 Micah Singleton, *Apple Pushing Music Labels to Kill Free Spotify Streaming Ahead of Beats Relaunch,* THEVERGE.COM (May 4, 2015), http://www.theverge.com/2015/5/4/8540935/apple-labels-spotify-streaming

40 Id.

b. Market Structure & Major Players

To examine of practices in the music industry is to examine an industry with some history of anti-competitive behavior in violation of antitrust law and fair trade practices.[41] As already discussed, Apple is the clear leader in non-streaming digital downloads, having "won the download market;"[42] but has, over the 2010s, faced a weakening of its market position. Three major record companies dominate the music industry, down from the six that existed 15 years ago.[43] In 2013, Universal Music Group (UMG) occupied 38.9% of the market, Sony Music Entertainment controlled 29.5%, and Warner Music Group had 18.7%.[44] Together they control about 89% of global music sales[45] and are the rights holders to a comprehensive back catalog of song recordings.

Streaming is a more competitive industry, with a range of companies including Spotify, Rdio, Rhapsody, Pandora, Tidal, and Google (with Google Play, Songza, and YouTube).[46] As discussed earlier, within streaming there is a divide between companies offering online-radio services like Pandora and other services offering on-demand

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41 Lee Knife, *Testimony Presented To The US House of Representatives Committee on the Judiciary Subcommittee on Courts, Intellectual Property and the Internet* (June 10, 2014), available at http://judiciary.house.gov/_cache/files/82d2bdbf-a92b-46f0-8829-a1ff040d1dfe/knife-dima-music-licensing-testimony.pdf.

42 Shirley Halperin and Ed Christman, *Apple Doesn't Want to Compete – It Wants To Own the Record Business*, BILLBOARD.COM, *(*Feb. 13 2015), http://www.billboard.com/biz/articles/news/digital-and-mobile/6472756/apple-doesnt-want-to-compete-it-wants-to-own-the-record

43 THE ECONOMIST, *supra* note 2.

44 Ed Christman, *supra*, note 6.

45 Matt Pollock, *Three Huge Record Labels Are Preparing to Take a Lot of Money From Their Artists,* MIC.COM (Jul. 17, 2014), http://mic.com/articles/93502/three-huge-record-labels-are-preparing-to-take-a-lot-of-money-from-their-artists.

46 Id. See also Glenn Peoples, *Google & Apple Show Strong Potential For Digital Music Apps in New comScore Mobile Report,* BILLBOARD.COM, *(*Aug. 22 2014), http://www.billboard.com/articles/business/6229137/google-apple-digital-music-apps-comscore-mobile-report.

listening, like Spotify or Rdio.[47] If one considers all of these services to constitute the "streaming industry," Pandora is the market leader with 31% market share.[48] The newest entrant in the streaming market is, of course, Apple with its Apple Music product, which launched on June 30th, 2015.[49] As a new competitor, its market share has yet to be established.

Understanding the digital music service industry is complicated by the interdependence of the various parties. The record labels have taken significant corporate stakes in music streaming services, demanding equity as part of the deal for licensing agreements.[50] The major labels have equity stake in both Beats and Spotify, and recent negotiations between the labels and SoundCloud also involved exchanging equity.[51]

Music is, of course, protected by the copyright law, and under that law, the streamers differ in how they gain access to music.[52] Pandora relies on a compulsory license and a statutory set fee; as relevant here, that means it cannot be harmed or

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47 Some "on demand services" still may not be entirely on demand based for all users based on subscription type—for example on Spotify as a free subscriber on mobile, a user does not have the ability to play songs on demand.

48 Philip Elmer-DeWitt, *iTunes Radio Overtakes Spotify, Gaining On iHeartRadio In U.S.*, FORTUNE.COM, (Mar. 11, 2014 10:05 AM), http://fortune.com/2014/03/11/itunes-radio-overtakes-spotify-gaining-on-iheartradio-in-u-s/.

49 Darrell Etherington, *Apple Music Launches With iOS 8.4 At 8 AM PT On June 30,* TECHCRUNCH.COM (June 29, 2015), http://techcrunch.com/2015/06/29/apple-music-launches-with-ios-8-4-at-8-am-pt-on-june-30/

50 Adam Satariano, *SoundCloud Said to Near Deals With Record Labels,* BLOOMBERG.COM (Jul. 10, 2014 6:54 PM), http://www.bloomberg.com/news/2014-07-10/soundcloud-said-to-near-deals-with-record-labels.html

51 Id.

52 Copyright Act of 1976, 17 U.S.C.§ 115. According to 17 U.S.C.§ 115, radio streaming services like Pandora are governed by the Section 115 compulsory license provision, which entitles these services to automatically obtain the license for a sound recording as long as they pay a royalty rate set by the government and comply with the processes outlined in 115; they do not need to negotiate with the record labels. On the other hand, companies like Spotify are not governed by the compulsory license provision, and must negotiate with the labels for their licensing rates. Since companies like Spotify are not governed by the compulsory provision, exclusive dealing contracts specifically hurt these companies because their agreements are completely negotiated with the labels and could be limited by exclusive windowing agreements.

excluded by exclusive deals between Apple and the labels. However all other types of streamers must negotiate with the labels for licenses to their catalogs of sound recordings.[53]

c. Market Definition

We have, to this point, used the industry's own market definitions; but it is well recognized that economic market definitions as used in antitrust law can sometimes deviate from industry usage. We can consider three main alternative frameworks.

Today, the industry and press draw a distinction between "digital downloads," (where the consumer buys a copy of the song and stores it locally, like iTunes) "streaming" (where the consumer has continuous access to songs through a computer or mobile device,), and physical sales (i.e., CDs or vinyl records).

It is possible that these are appropriate market definitions, in which case Apple, based on its market share, may be likely inferred to enjoy market power and perhaps monopoly power in the digital download market. Apple's market share has varied between 70% and 60%; its main competitor in downloads is Amazon, with 22% of the market in 2013.[54]

Whether this is an appropriate market definition, under *Dupont*[55] is whether consumers consider streaming and downloads substitutes, non-substitutes, or even

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53 Digital music providers need licenses for all aspects of the music, including compositions and sound recordings. Typically the labels possess the licenses for the sound recordings, and for the purposes of this note the focus will be on sound recording licenses that the lables manage. See Knife, *supra* note 23, at 3.

54 Yoni Heisler, *iTunes Maintains Its Music Downlaod Dominance as Amazon Plays Catch-Up*, ENGADGET.COM (April 17, 2013), http://www.engadget.com/2013/04/17/itunes-maintains-its-music-download-dominance-as-amazon-plays-ca/

55 *United States v. E. I. du Pont de Nemours & Co.*, 351 U.S. 377 (1956)

possibly complements. The industry and press, referring to streaming and downloading as separate markets, also often refer to streaming as a substitute for downloads. This is evidenced by statements like Apple "losing" consumers to streaming services,[56] and the fact that industry experts suggest streaming music will universally overtake digital downloads in the near future.[57] This suggests two other alternatives. First, that the correct market definition might simply be digital music in general, in which case Apple's market power, while not insignificant, may be less than the narrower market definition would suggest.

The other possibility is that music streaming is not a current substitute, but a future substitute – a technological challenger for the market for downloaded music. As such, the streamers would be in the same position as Netscape's browser was to the Microsoft Windows operating system in the late 1990s (Apple Music, in this analysis, is the equivalent of Microsoft Explorer). In this view the products are not direct competitors, but rather, the streamers are a product that could come to be understood as a full substitute for iTunes, and therefore a threat to Apple's dominance.

If digital downloads and streaming are separate markets, a related question is whether the Pandora-style "radio" and Spotify "on-demand" streaming are themselves in the same market. As a functional matter, services like Spotify and Pandora are quite different; most importantly, one cannot fully control the songs one listens to on Pandora, unlike iTunes and Spotify, but merely specify an artist or genre (and even if an artist is specified, Pandora may play "similar" artists. For example, Nicki Minaj my play on the

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[56] Andy Fixmer, *Apple's 10 Year Old iTunes Loses Ground to Streaming,* BLOOMBERG BUSINESS, (April 25, 2013), http://www.bloomberg.com/bw/articles/2013-04-25/apples-10-year-old-itunes-loses-ground-to-streaming

[57] Brad Reed, *A Win For Apple (*May 15, 2015), http://bgr.com/2015/05/15/apple-beats-music-vs-spotify-free-streaming/

“Beyonce” channel). Based on these facts it is possible that digital downloads and the streamers are in the same market, while the “radio” services are in a different market. However this is complicated further by the fact that Spotify, an “on-demand” service, only offers “radio-style” music on mobile to subscribers. Full consideration of the market definition issues here discussed depends on data and economic analysis not available to the authors or necessarily in existence.

Finally, we should make clear that the question of whether Apple has market power in the music distribution market is not limited to an analysis of circumstantial evidence like market share, for direct evidence may also be considered. In the *Toys-R-Us* case[58], the Seventh Circuit noted that market power might be evident from the very ability to push the entire industry into exclusive agreements. It is possible that Apple’s very power to pressure the labels, who are themselves a concentrated industry, to act in ways that may seem contrary to their interests may prove a direct demonstration of market power. Such direct theories of market power ultimately depend on a more careful economic analysis of Apple’s dealing with the labels, which is beyond the scope or data available to this paper.

A finding of market power typically depends on some existence of barriers to entry, which in Apple’s case are not that hard to demonstrate. For one thing, entry depends on access to music licenses, and industry history suggests, there are only a limited number of firms who are trusted by the labels and meet the upfront capital-intensive requirements to offer a competitive service. Considering full competition with iTunes, there are also structural barriers. By integrating music with Apple’s iOs

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58 *Toys R Us, Inc. v. Federal Trade Commission*, 221 F.3d 928 (7th. Cir 2000)

operating system,[59] Apple can ensure consumers will continue to use their music products given the synergies and ease that come from integration with the Apple operating system. Apple can utilize its 850 million credit cards on file and integrate with its 1 billion iOs devices sold, something an entrant would find difficult to match.[60] By preloading apps on Apple devices and storing credit cards, Apple has mastered the distribution problem that other companies face.

Part II: Conduct

a. Windowing and Other Exclusive Practices

For historic reasons, windowing is a fairly common practice in the media industries other than music.[61] Film theaters were traditionally divided into first-run and second-run theaters, and audiences remain accustomed to movies launching first in theaters before becoming available in different, home, formats like the DVD, video on demand or Netflix.[62] The same model has also come to television, where hit shows premiere on the network that owns or underwrites them, only later moving to other distribution platforms.[63] In publishing, similarly, the hardcover traditionally preceded

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59Josh Constine, *Apple, The Record Label?* TECHCRUNCH.COM (Feb 8. 2015), http://techcrunch.com/2015/02/08/exclusive-streaming/#CPdSdP:gut; See also James Cook, *Why Apple Wants to End the Era of Free Music Streaming* (May 5, 2015), businessinsider.com, http://www.businessinsider.com/free-music-streaming-was-a-big-experiment--and-now-major-record-labels-are-declaring-it-a-failure-2015-5

60Id.

61Philip Ingehlbrecht, *The Music Industry Is About To Change, and Apple And U2 Are Just The Beginning,* TECHCRUNCH.COM, (Sep. 13 2014), http://techcrunch.com/2014/09/13/the-music-industry-is-about-to-change-and-apple-and-u2-are-just-the-beginning/

62 Id. However, recently there has actually been movement away from windowing in TV and movies. Netflix is leading the change in this area, disrupting the current model and looking to restore choice and options by moving to day and date releases. See Scott Roxborough, *MIPCOM: Netflix's Ted Sarandos Talks "Antiquated Movie Distribution Model,"* THE HOLLYWOOD REPORTER, (Oct. 14 2014, 3:54 AM), http://www.hollywoodreporter.com/news/mipcom-netflixs-ted-sarandos-talks-740591.

63 Jason Epstein and Rob Glaser, *Why Streaming (Done Right) Will Save the Music Business*, RECODE.NET (Nov. 21 2014), http://recode.net/2014/11/21/why-streaming-done-right-will-save-the-music-business/

the paperback, which was sold for a cheaper price. Windowing is usually accomplished by an exclusive contract between the content owner and a distributor – say, when a TV show is available exclusively on HBO, and then later sold by other distributors.

Economists have generally understood windowing practices as a means of price discrimination.[64] The early time-window, with a higher price is meant to capture consumers with a higher willingness to pay, while those willing to pay less get later-in-time versions.[65] For the seller, windowing, like other forms of price discrimination, can yield increases in revenue. For the consumer, the implications are ambiguous; consisting of a reduction of consumer surplus but also an elimination of deadweight loss.[66]

Music does not have a similar tradition of windowing. Instead, until the 2010s, a new record or single would be launched on radio at the same time as it became available for sale in record stores (or later, on iTunes). Sometimes singles would be launched before or after albums, generally with the goal of targeting younger audiences. One of the questions presented, then, concerns a spread of exclusive-based windowing to an industry that did not previously have such a practice. The question, however, is not usefully considered in the abstract. The relevant question, as we shall see, is whether windowing or exclusives may be employed as a means to maintain Apple's dominant position in online music sales, or potentially, to maintain the dominant position of the three major music labels.

Over the last five years or so, Apple has pioneered exclusive-windowing in the music industry. So far there is no general pattern – instead, it occurs primarily in the

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[64] The Economic Regulation of Broadcasting Markets: Evolving Technology and Challenges for Policy, Edited by Paul Seabright and Jurgen Von Hagen, Cambridge University Press, April 26, 2007, p. 92

[65] Philip Ingehlbrecht, *supra* Note 34.

[66] Jason Epstein and Rob Glaser, *supra* note 36.

form of one-off individualized agreements between labels and retailers at the artist level.[67] A label may represent dozens of artists and yet only negotiate a windowing deal with Apple for one of their artists. The kind of windowing seen most frequently today is when artists launch music first on iTunes as digital downloads before making it more widely available on streaming services.[68] Some artists and labels have chosen to withhold music from streaming entirely because they feel the royalties are inadequate and that streaming dilutes digital sales.[69] Taylor Swift and her label, Big Machine, have been outspoken about the fact that they believe streaming doesn't compensate artists adequately.[70] However, Swift's music remained available to paid subscribers on other streaming services,[71] and there is speculation the decision was tied to the fact that Big Label was up for sale and the label was trying to increase revenue from Swift's iTunes sales. This just further exemplifies the power Apple has, in a position to offer attractive solutions to artists in exchange for withholding music from other services.

The current examples of windowing in the music industry have varied widely in duration. Beyonce's album was a one-week iTunes exclusive, Sam Smith's album "In the Lonely Hour" was withheld from streaming for one month, while U2's exclusive lasted about five weeks.[72] The time frames generally have been short, compared with movies or

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67 See Ben Sisario, *Sam Smith, Up for Six Grammys, Is Getting Used to Arenas,* nytimes.com (Feb. 4 2015), http://www.nytimes.com/2015/02/08/arts/the-crowds-stay-with-him-and-grow.html?_r=0 (Capitol Records with the release of Sam Smith's album "In The Only Hour" withheld the album from streaming for a month to drive sales).

68 Dawn C. Chmielewski and Randy Lewis, *supra* note 25.

69 Kelsey McKinney, *Is Streaming Bad for Artists? Yes and No. The Future of Music, Explained,* VOX.COM (Dec. 17 2014), http://www.vox.com/2014/11/24/7272423/taylor-swift-spotify; Aloe Blacc, *Streaming Services Need to Pay Songwriters Fairly,* WIRED.COM, (Nov. 5 http://www.wired.com/2014/11/aloe-blacc-pay-songwriters/2014),

70 Hannah Karp and Sven Grundberg, *supra* note 14.

71 Id**.**

72 Ed Christman and Alex Pham, *supra* note 7; Ben Sisario, *supra* note 112.

the nine-year long contracts common to sports broadcasting rights.[73] The more serious competition questions come not from these, one-off deals, but rather the prospect of widespread windowing by entire labels, or perhaps by all the labels, particularly if orchestrated by Apple, when used as a way to attract new subscribers to Apple's music services and prevent consumers from defecting.[74]

b. Banning Competitor Business Models

A different form of conduct that Apple has considered, according to widespread reporting, is pushing the labels to refuse to deal with streaming companies who employ an advertising-based revenue model, commonly known as "freemium".[75] Streaming companies, in general, have two business models – paid subscribers and advertising-based. Advertising-based streaming, like broadcast radio, places a commercial between a certain number of songs, and therefore appears "free" to the listener. Paid subscribers, in contrast, enjoy streaming music without interruption in exchange for a monthly payment The advertising-model is important to streaming services for two reasons. First, there are some consumers who will never become paid-subscribers, and the advertising-based service is therefore the only way to sell to such customers and capture this audience. If this service was not available, these users would likely resort to free music elsewhere, including use of pirate sites. Second, the ad-based service serves as a means for a new consumer to trial the service, become used to it, and later become a paid

73 Robert T. Sharkey, *supra* note 84.

74 Brad Reed, *A Win for Apple: Spotify will Reportedly Severely Restrict Its Free Streaming Tier"* (May 15, 2015), http://bgr.com/2015/05/15/apple-beats-music-vs-spotify-free-streaming/

75 Ty Pendlebury, *Spotify Rival Deezer Launches Podcasts, Questions Freemium Services cnet.com (May 19, 2015), http://www.cnet.com/news/spotify-rival-deezer-launches-podcasts-questions-freemium-services/*

subscriber.[76] As such it is important to growing the subscriber base of the streamers. For example, 80% of Spotify's 15 million paying subscribers started out as free users, before converting.[77]

The banning of a freemium or ad-revenue model, in its most serious form, looks like the following. Apple individually pressures each label, using carrots and sticks, to refuse to deal with any streaming service that relies on an ad-based revenue model. The carrots and sticks available include better or worse treatment on iTunes or Apple Music, payment terms, or others. As such, if Apple's strategy is successful, the labels may all end up jointly refusing to deal with the streamers in their advertising-based mode, thereby eliminating a form of lower-priced competition to Apple Music and iTunes.

Part 3: Antitrust Analysis

a. Joint Refusal to Deal / Parallel Exclusion

The first question is whether widespread exclusives or refusals to deal with advertised streamers may represent a species of parallel exclusion or a joint refusal to deal under the authority of *Northwest Stationers* in violation of Section 1 of the Sherman Act.[78] This theory, notably, may imply liability not just for Apple, but for the record labels as well.

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[76] Spotify reports a free to paid conversion rate of 25%, one of the highest in the industry, compared to other freemium services like DropBox and Evernote which have about a 1-5% conversion rate. See http://www.createinteractions.com/designtech/2015/1/13/spotify-growth-analysis-product-strategy

[77] John McDuling, *The Music Industry Wants to Fight the Internet Again—And It's Probably Going to* Lose, Quartz, (March 23, 2015), http://qz.com/360002/the-music-industry-is-going-to-fight-the-internet-again-and-its-probably-going-to-lose/

[78] *Northwest Wholesale Stationers v. Pac. Stationary*, 472 U.S. 284 (1985).

In recent decades, the *Toys R Us*[79] litigation provides some sense of what such a case would look like. In the early 2000s, Toys R Us generated scrutiny when the company responded to threats in the industry coming from discount club competitors by limiting the accessibility of toys to these retailers. In *Toys R Us v. the Federal Trade Commission*, the Seventh Circuit affirmed the FTC's finding that the toy company acted as a coordinator of agreements among a number of toy manufacturers in violation of Section 1.[80] Toys R Us entered into individual vertical agreements with 10 manufacturers that restricted the manufacturers from selling certain products to discount clubs, which was, at the time, a new business model competing with Toys R Us. While the individual agreements were vertical between supplier and retailer, the Seventh Circuit found Toys R Us also orchestrated a horizontal agreement as between the toy manufacturers by coercing the suppliers to cut off supply to the clubs. The course of dealing was relevant to the litigation, as Toys R Us actively influenced manufacturers to cut off a profitable sales outlet that they previously supplied products to.[81]

Another, even more directly obvious parallel to the pressure to ban freemiums is Apple's own coordination of pricing agreements in the *eBooks* case.[82] There, Apple met with individual book publishers and convinced them to, effectively, jointly raise their prices by adopting an "agency" model which restricted the ability of retailers like Amazon to offer discounts.[83] Apple had strong incentives to encourage publishers to act collectively and an interest in limiting retail competition, and therefore attempted to

79 *Toys R Us, Inc. v. Federal Trade Commission*, 221 F.3d 928 (7th. Cir 2000)
80*Toys R Us* at 930.
81 *Toys R Us* at 935-936.
82 *In re Electronic Books Antitrust Litigation,* 859 F.Supp.2d 671, 684 (S.D.N.Y. May 2012).
83 *Id.*

indirectly limit Apple's horizontal competitors' ability to compete.[84] There, as in Toys R Us, Apple played the critical role of a coordinator of a hub-spoke conspiracy, as opposed to a horizontal member of the conspiracy. While the recent litigation may serve as a deterrent, the music industry presents similar challenges to the company that suggest Apple might be willing to engage in similar activity in the future.

In the music industry, Apple, like Toys R Us, runs the risk of being understood as a coordinator of a horizontal agreement not to deal with Apple's streaming competitors, or alternatively, of a simple price-fixing agreement. If, for instance, ultimately all three of the major record companies engaged in exclusive licensing agreements with Apple, and also agreed not to allow music to be distributed on an advertising-revenue basis, either course of conduct could result in serious antitrust scrutiny.

As a matter of antitrust law, the first pattern of conduct is technically a joint refusal to deal, subject to per se illegality under the authority of *Northwest Stationers*.[85] The second – an agreement not to deal with advertising-based services – may be considered a coordinated manipulation of price under *Intrastate Circuit*, and as such similar to the recent Apple eBooks case.[86]

Each of the claims faces various challenges. The first is finding evidence of an actual agreement (or an attempted agreement, or an invitation to collude). All of the conduct described here might be described as action taken independently by the labels in their independent self-interest. For example, the labels may argue, persuasively, that its exclusive deals with Apple represents merely an independently motivated, win-win deal between label and Apple as its distributor, and nothing beyond that. Similarly, a label

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84 *Id.* at 684-685.
85 *Northwest Stationers* at 289-298.
86 *Interstate Circuit v. United States,* 306 U.S. 208 (1939).

may argue that its refusal to deal with freemium streamers represents merely a unilateral, independent business decision not to deal with a "discount" distributor, and one that, under the *Colgate* doctrine is not subject to antitrust condemnation at all.[87]

The question of whether an agreement exists at all for either of these species of conduct could be settled by direct evidence. Meetings and communications are common in the industry, and – as with the eBooks case – there is perhaps evidence of an agreement reached at a meeting between the labels and Apples. Examples of relevant communications would include threats from Apple executives to bury artists' songs in the iTunes store or limit upfront payments, unless labels withdraw from free streaming services, or alternatively, promises to better promote artists, but only if the labels refuse to deal with "freemium" services. Another, and more likely scenario is one akin to Toys R Us or Apple's eBook litigation, where vertical agreements were evident, and the court was willing to infer the existence of a horizontal agreement from the vertical conduct and agreements.

There are important parallels between the *Toys R Us* litigation and music streaming that may suggest the utility of that case for understanding the current situation. As with streaming, Toys R Us was reacting to competition emerging from warehouse clubs, a new distribution channel changing the industry in a way that was challenging its market position. Toys, like music, are fad-driven products, and retailers want to be able to sell the season's hottest items to their customers,[88] which made the restriction and denial of merchandise in Toys R Us detrimental. Similarly, in the music industry, a new song is a hit for limited amount of time, after which consumers may lose interest in

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87 *United States v. Colgate & Co.,* 250 U.S. 300 (1919).
88 *Toys R Us* at 931.

gaining access to it. The course of dealing was important to the case – in *Toys R Us,* the courts were concerned by the "abrupt shift" that occurred, where manufacturers that previously supplied toys to the clubs stopped and cut off a legitimate profitable sales source.[89] Similarly, the music companies currently rely on multiple services for revenue. If they stopped licensing music to retailers other than Apple, even for just a period of time, one should be skeptical. Especially considering the growth of streaming, and how much revenue labels are reporting from streaming,[90] it seems curious for the labels to now consider cutting off a profitable revenue source while there is so much opportunity evident.[91]

Ultimately, Apple's actual role in negotiations would be critical to any potential antitrust claim. It was clear in *Toys R Us* that the manufacturers wouldn't have entered into the agreements without Toys R Us ensuring them that their competitors were doing the same thing. The agreement did not seem like it was in the manufacturers best interest and yet they agreed to it because of what Toys R Us promised. With music, it seems more likely that if all of the labels agreed to exclusives they would be doing so because they believed it would ultimately help them make more money and sell more songs. However, if evidence appeared that Apple played an active role in inducing the labels to withdraw their music from other services, by offering incentives or making threats, Apple could find itself in a similar situation as Toys R Us.

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89 *Toys R Us* at 935.

90 Supra note 18 and 19.

91 The International Federation of the Phonographic Industry (IFPI), a nonprofit organization representing recording companies around the world, released their annual report in April, which showed digital revenues worldwide for the first time equaling revenues from physical media, keeping overall revenue stable for the industry after years of decline. "Streaming and physical media can coexist in a way physical and downloading couldn't," reckons Jacob of the IFPI, which demonstrates the enormous opportunity that exists with streaming. See Rich Trenholm, *Streaming May Save Record Industry, Says One Insider* CNET.COM (May 14, 2015), http://www.cnet.com/news/streaming-may-save-record-industry-says-one-insider/

b. Price Manipulation/Maintenance

A strong claim against Apple and the music labels relies on a theory that pressuring streamers to abandon advertising-revenue based models is a form of price manipulation that is *per se* illegal under Section 1 of the Sherman Act, or retail price maintenance *per se* illegal in some states (including California, Apple's home). The *Socony-Vaccum* case made clear that the federal antitrust laws ban any price fixing agreement that tampers with the "central nervous system" of the economy.[92] Presuming a horizontal agreement to ban free streamers were found, is that ban a species of horizontal price manipulation falling under the authority of *Socony-Vaccum*? Or should it be considered a form of vertical price maintenance under *Leegin*[93], or something else entirely?

A general agreement to ban advertising-revenue driven models may be understood as an agreement not to sell music at its lowest-price point, and in this sense a manipulation of prices. The theory relies on the idea that the consumer of advertising-paid music regards the product as "free," (even if in fact she is paying by listening to the advertisement.) As a customer whose purchase point is at or near "free" she occupies a position on standard demand curve very close to the bottom. An agreement to eliminate sales at this part of the demand curve is not unlike an agreement not to offer large discounts, and, if an agreement can be identified, as such is likely a *per se* violation of the Sherman Act.

In the *eBooks* case, Apple was found by the district court to be the coordinator of a horizontal scheme among the publishers to raise book prices. Apple's conduct

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92 *United States v. Socony-Vacuum Oil Co., Inc.*, 310 U.S. 150, 224, n. 59 (1940).
93 *Leegin Creative Leather Products Inc. v. PSKS Inc*. 551 U.S. 877 (2007).

consisted of coordinating the signing of identical vertical agreements with suppliers and in other ways facilitating collusion.[94] That collusion, moreover, was useful to Apple, as it effectively raised the price of its retail competitor (Amazon). The same logic may apply to a case in which Apple convinces the labels to pressure the streamers to effectively raise their prices by eliminating the "free," or ad-supported advertising option.

Alternatively, it is possible that the ban on ad-rev models can be considered a form of retail price maintenance. Under this theory, by specifying in a vertical agreement that a streamer cannot offer a "free" option, the labels are specifying a minimum retail price, namely something more than free / ad-supported. That vertical agreement would be examined under the rule of reason under federal law, but would be *per se* illegal in some of the states that Apple operates, including its home state of California. [95]

c. Monopoly Maintenance

A Section 2 analysis of Apple's conduct in the music industry relies on some version of the following theory. Apple, having long held a monopoly over the online sales of music, has reacted to the threat of losing its dominant position to more innovative competitors – the streamers – with various forms of exclusionary conduct. It has attempted to starve the streamers by signing exclusive windowing agreements with the labels, starving them of "hits" and therefore weakening them as competitors. It has, second, pressured the labels to weaken the business models and new user acquisition by

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94 *In re Electronic Books Antitrust Litigation,* 859 F.Supp.2d 671, 684 (S.D.N.Y. May 2012).
[95] *Antitrust Alert: California Challenges Minimum Resale Price Maintenance as Per Se Illegal*, Jones Day Press Release (March 2010), http://www.jonesday.com/antitrust-alert--california-challenges-maximum-resale-price-maintenance-as-per-se-illegal-03-19-2010/; See also *Mailand v. Burckle*, 572 P.2d 1142, (Cal. 1978).

its competitors by forcing them to abandon advertising-revenue models. Considered individually, or perhaps in combination, these strategies effectively have helped Apple maintain its monopoly over digital downloaded music. Depending on the facts, Apple may also be attempting to illegally monopolize the online streaming market with Apple Music.

The facts to support the theory just stated have not been demonstrated, but rather present what a strong version of a Section 2 claim would look like. We now consider a few particulars. A Section 2 claim requires, first, a finding of monopoly power, which is debatable here. We have previously discussed the various market definitions possible in this case and the implications of a finding of monopoly power. Worth highlighting is the idea that Apple may be currently in a similar position as Microsoft in the 1990s, where it was, initially slow to realize the potential significance of streaming and aggressively redirected its efforts in order to maintain the monopoly.[96] However, if the music market is the entire digital music market, including both streaming and downloads, it is possible Apple's market share is lower.[97] Additionally, the very exclusionary conduct Apple engages in, like in *Microsoft*, is only rational if the firm knows it possesses monopoly power.

A finding of monopoly power alone is not sufficient to state a Section 2 claim, there would also need to be evidence that Apple anticompetitively maintained that power. The antitrust analysis would require determining whether the exclusive restraints are likely to have anticompetitive effects, and, if so, whether the restraint is reasonably necessary to achieve procompetitive benefits that outweigh those anticompetitive

[96] See *United States v. Microsoft Corp.,* 253 F.3d 34 (D.C. Cir. 2011)
97 Glenn Peoples, *supra* note 35.

effects.[98] Given the fact that anticompetitive effects and procompetitive efficiencies become more significant as exclusionary conduct is adopted at greater scale, it is clear that one-off exclusive license agreements at the artist level would likely not be in violation of antitrust laws. However, at some point, windowing on a grander scale or banning the free streaming service would generate antitrust concerns.

Anticompetitive Effects

The challenge for a claim based either on a Section 1 or Section 2 theory would be the determination of anticompetitive effects, particularly in light of the pro-competitive justifications that Apple is likely to develop and present.

Windowing, or even widespread industry exclusives, whether premised on Section 1 or 2 theory, may prove more difficult to conclusively demonstrate consumer harm from. To challenge the legality of an exclusive dealing, historically the Supreme Court has focused on whether the arrangement "forecloses competition in a substantial share of the line of commerce affected."[99] However, in recent years, court of appeals have taken into account broader factors when assessing legality, including the nature of the product and relationship between the parties, the percentage of the market foreclosed to rivals as a result of the arrangement, and the duration of the arrangement.[100] The court of appeals case law suggests that short durations usually, but not always, can negate a

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98 U.S. Dep't of Justice and Federal Trade Commission; *supra* note 44.

99 U.S. Dep't of Justice, *supra* note 37 at 132. See *Standard Fashion Co. v. Magrane-Houston Co.*, 258 U.S. 346, 357 (1922); see also S*tandard Oil Co. of California v. United States,* 337 U.S. 293, 314 (1949).

100 U.S. Dep't of Justice, *supra* note 64 at 132, 134.

finding of foreclosure.[101] On the other hand, dealings may be illegal if the arrangement reasonably makes a significant contribution to maintenance of monopoly power or leaves rivals with significantly higher transaction costs or other risks leaving the rival unable to pose a real threat to the monopoly.[102] Additionally, exclusive dealings can be particularly difficult to assess because they may provide benefits while at the same time impeding rivals' ability to compete. In those cases, "what makes exclusive dealing potentially harmful is the very same mechanism that makes the arrangement efficient and may lead to lower prices for consumers."[103]

As this suggests, one-off exclusives or windowed songs are difficult to describe as strongly anticompetitive. Instead, the strongest theory of harm relies on the following ideas. Widespread windowing, even with short durations, creates harm to competition at the retailer level, because by limiting other retailers' accessibility to "new" music, the other retailers will become "second-run" distributors who are unable to truly compete with Apple, the dominant player. This relies in part on the theory that, while other music may remain available on competitors' services, there is no true substitute for the specific music being restricted. The harm is therefore proportional to the popularity of the artist, in addition to how many artists or labels engage in the practice. If all of the music by the most popular artists was not available on rival services, this would likely lead consumers to stop using the other services. At an extreme version, Apple exclusives might create a

101 U.S. Dep't of Justice, *supra* note 64 at 134-136 (citing authorities *Roland Mach. Co. v. Dresser Indus., Inc.*, 749 F.2d 380, 395 (7th Cir. 1984); *Omega Envtl. Inc. v. Gilbarco, Inc.,* 127 F.3d 1157, 1162 (9th Cir. 1997)).
102 U.S. Dep't of Justice, *supra* note 64 at 134-136 (citing authorities *United States v. Microsoft Corp.*, 253 F.3d 34, 64 (D.C. Cir 2001) (en banc) (per curuiam); *United States v. Dentsply Int'l, Inc.*, 399 F.3d 181, 191-93 (3d Cir. 2005)).
103 U.S. Dep't of Justice, *supra* paper 64 at 132.

situation like that encountered in *Pecover v. Electronic Arts* litigation, involving an exclusive license to the entire roster of all members of the NFL.[104]

Ultimately the duration of exclusives would play a large role in a finding of harm. Whether an exclusive is available for one week versus one month would make a meaningful difference. Limiting access temporarily is quite different from foreclosing access permanently. Currently most exclusives last a few weeks up to a month, which is much shorter than the types of perpetual or long-term licenses that have more typically been of concern.

There are several important limitations to the theory of harm from exclusives. First, the extent of the exclusion that Apple and the labels may achieve may always face a limit from the compulsory licenses in the federal copyright law. The radio services like Pandora can automatically obtain licenses to distribute music by paying the compulsory rate.[105] If Pandora and similar services are considered part of the same market as the streamers – an open question – this may limit the effect of any exclusive deals. For this reason, the impact on the music market may never reach the 40-50% threshold typically required for a Section 1 claim. However, this would not necessarily prohibit the finding of a Section 2 violation. As the *Microsoft* litigation illuminated, to prevail on a Sherman antitrust claim, the market share foreclosed in a Section 2 case can be less substantial than in a section 1 case.[106]

There is also a risk of anticompetitive coordination given the concentrated nature of the music market and the fact that there are very high barriers for entry.[107] This

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104 *Pecover v. Electronics,* 2010 WL 8742757, N.D. Cal Dec 21, 2010.
105 Copyright Act of 1976, 17 U.S.C.§ 115
106 U.S. v. Microsoft at 70.
107 Id.

anticompetitive effect is relevant to both exclusives and the ban on ad-revenue streaming. High barriers exist because it is incredibly difficult and costly to obtain licenses to be able to provide a legal platform for digital music. Licensing costs are the highest operating costs for streaming companies and their biggest challenge to maintaining profitability.[108] This inherently makes it more difficult for a smaller streaming company to compete with Apple and exclusives by companies like Apple only compound this. Additionally, given the fact that there are only three major record companies, if Apple pressured one or two labels into windowing or limiting music to "free" streamers, the third will also likely be forced to follow. This coordinated behavior has been exhibited before. After Universal made a licensing agreement with Spotify, since E.M.I. and Sony had already negotiated with the streaming service, Warner was "virtually compelled to join the other major labels in negotiating."[109] This coercion occurred while there were four major record companies, now with only three the likelihood of coordination is even greater. Additionally, given the business model of a company like Spotify that is reliant on maintaining a robust catalog of music, one label's decision to limit their access to music would probably be enough to cause significant damage.

The anticompetitive effects can also be described in terms of their impact on innovation. The streamers represent a technological advance over the iTunes store. To the degree Apple's conduct slows or ultimately renders streaming a second-rate service, it has impeded innovation in the delivery of music. Spotify's product, with a premium and free ad-based service, has generated significant benefits to rights-holders, contributed to substantial revenue growth in the industry, and solved serious problems in the music

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108 Spotify pays out nearly 70% of its total revenue to rights holders. (See: https://www.spotifyartists.com/spotify-explained/)
109 Id.

industry (like capturing a new audience previously reliant on piracy). To stunt that development now by eliminating the free tier of streaming would be a threat to innovation. However, this point is weakened, somewhat, by Apple's own introduction of its own streaming service. But it is also true that if any innovation in music distribution faces the prospect of anticompetitive elimination, the incentive to innovate in the future may be reduced.

Another, particularly interesting question is the impact of Apple or the label's conduct on piracy. The elimination of a free ad-tier service would likely result in a resurgence of piracy. We should mention that it is not clearly the job of the antitrust law to fight piracy – in fact, an economist, disregarding the law, might see content piracy as effectuating antitrust's interest in lower prices. But the prospect of increased piracy might, alternatively, be considered a form of indirect anticompetitive effect, that is, a drain on the legitimate competition that antitrust is meant to promote. The people who do not convert to Spotify's premium service are consumers who have actively chosen not to pay for their music. If the free tier were eliminated, these people would likely seek an alternative free music option (if it exists), or pirate music.

Additionally, according to a Spotify study conducted in the Netherlands, artists who held out from offering releases on the service experienced higher levels of piracy than other artists.[110] Robbie Williams and One Direction released singles on Spotify the same day as other music channels and sold 4 copies for each illegal download.[111] On the other hand, Unapologetic by Rihanna and Taylor Swift's Red were both withheld from

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110 Will Page, *Adventures In The Netherlands: Spotify, Piracy and the New Dutch Experience,* SPOTIFY RESEARCH REPORT, at 2 (Jul. 2013).

111 Id. at 18.

Spotify and sold only one copy for each illegal download.[112] Rihanna released her singles on Spotify after holdbacks between 2 and 5 weeks, and once available on Spotify the piracy demand weakened.[113] The study also concluded that from the sample there was no evidence that withholding music from the service even led to more sales, suggesting a hit is a hit regardless of it's availability, but that if you limit it's availability people will continue to find it through illegal means. This study demonstrates that the risk of a resurgence in illegal downloads is certainly a foreseeable consequence if windowing were to become more mainstream. Placing limitations on the ability to access digital music legally would inevitably undo many of the advances made in recent years to combat piracy. Ironically a business practice such as windowing intended to improve market conditions could in fact end up doing more harm than good.

Procompetitive Justifications

Assuming some existence of anticompetitive harm, there are important procompetitive efficiencies that need be considered. Some of the antitrust theories considered here, including horizontal price manipulation and the *per se* version of retail price maintenance, do not include a consideration of procompetitive benefits, but others do.

Exclusive deals and windowing, as suggested above, are common practices in the media industries, and, as already stated, may be viewed as a form of price discrimination, which should, in theory, be of some utility to consumers who wish to pay less. The theoretical benefits for consumers, however, are not well supported here, where

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112 Id at 17-18.
113 Id.

windowing would simply yield some music being unavailable at a lower price. The ban on "free" options, moreover, finds no defense under a theory of price discrimination.

More generally, when exclusive vertical restraints are allowed, it is because of the efficiencies that result from collaboration between distributor and manufacturer. Exclusive dealings can help consumers because the arrangements encourage distributors to devote their efforts to manufacturers' brands, increase loyalty, and cause distributors to more proactively promote the products.[114] These types of advertising and promotional investments ultimately might benefit consumers but might not be provided absent exclusive agreements.[115] In exchange for exclusivity deals with artists and labels, Apple in return features the artists in the iTunes store.[116] The Apple U2 deal is just one example of this. Apple was incredibly invested in marketing the launch of U2's album, committing to a $100 million valued marketing campaign including a global television campaign as part of the exclusive deal with the band.[117] The launch included an extreme form of proactive promotion, including an attention grabbing media event where it was announced that iTunes users would not even have to pay for the album—it was a "gift from Apple to their customers."[118] In this case, exclusive dealing can be seen as creating a dedicated, loyal distributor who is committed to promoting U2's products, like the gas stations in the Standard Stations case. This case also exemplifies how exclusives might yield some innovative distribution strategies. With the security of an exclusive, Apple and U2 were able to experiment with the launch and the novel concept of a "gift" that

114 U.S. Dep't of Justice, *supra* note 37, at 138-139.
115 Id. at 139.
116 Josh Constine, *supra* note 128.
117 Ben Sisario, *For U2 and Apple, A Shrewd Marketing Partnership*, NYTIMES.COM (Sep. 9 2014), http://www.nytimes.com/2014/09/10/business/media/u2-appears-at-apple-event-and-songs-of-innocence-appears-free-on-itunes.html
118 Id.

automatically appeared in users' music libraries. Of course, that "gift" proved unpopular, and was widely viewed as an intrusion, but it was an interesting experiment nonetheless.[119]

The challenge with justifying windowing is that many of the standard benefits of exclusive dealings are not present in the windowing context given the nature of the product. Additionally, benefits from banning a "free" streaming service are even more tenuous. Benefits such as assuring adequate supply and allowing suppliers to anticipate demand[120] do not exist with digital music, where the supply is endless. Additional frequently cited efficiencies such as facilitating distribution and long-term planning and minimizing costs and risks in uncertain markets, which lead to increased operating efficiencies and therefore decreased costs to consumers,[121] are less relevant, although not completely absent, with digital music services. Exclusives are also often justified as preventing costly free-riders.[122] In the case of digital music, there is no classic free-rider justification because whatever assets the labels provide retailers like Apple, Apple cannot then use to promote other music given the inherently unique nature of each song. However, with exclusives Apple can more freely promote its artists without fearing a user will then go to an alternate service to listen to that artist.

Without the typical exclusive efficiencies, it is difficult to justify windowing and the ban on free streamers. Nevertheless, companies engaging in windowing argue they

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119 Christopher Williams, *Apple Tie-Up With U2 Branded a 'Dismal Failure' by Music Retailers,* TELEGRAPH.CO.UK, (Sept 16. 2014), http://www.telegraph.co.uk/finance/newsbysector/mediatechnologyandtelecoms/digital-media/11098907/Apple-tie-up-with-U2-branded-a-dismal-failure-by-music-retailers.html

120 U.S. Dep't of Justice, *supra* note 37, at 139.

121 Wanda Jones Rogers, *Beyond Economic Theory: A Model For Analyzing The Antitrust Implications of Exclusive Dealing Arrangements,* 45 DUKE L.J. 1009, 1018 (1996).

122 Id.

have legitimate business justifications for doing so. The music industry is in a tenuous state. Industry insiders predict a continued downfall of sales and irrelevancy of the album as an economic entity in the future.[123] Artists criticize the current payouts they receive from streaming, and believe withholding music from streaming will lead to more sales.[124] It could be argued that exclusives or banning free streamers can lead to more efficient licensing rates —as the sole retailer and without "free" customers, the business might be able to negotiate better rates. It could also be argued that distributing music to fewer platforms reduces transaction costs. Advocates of windowing view the practice as a way to make the music industry more profitable. However, the data is not conclusive on whether withholding from streaming actually directly increases sales.[125] Nevertheless, under *Colgate* it is clear that an artist or label can choose to withhold their music from a particular format if they do not believe it is economically advantageous.[126]

CONCLUSION

Today's one-off exclusive windowing, as already suggested, seem unlikely to be enough of a source of competitive harm to warrant serious antitrust condemnation, unless considered part of a large exclusionary scheme. Breath and duration of an exclusive is critical to a finding of reasonableness under an anticompetitive analysis.[127] As it stands,

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123 "This year, no new title has cracked the one-million-sales mark — a symbolic milestone — and album sales over all are down 14 percent from the same period last year." Ben Sisario, *Taylor Swift's '1989' Carries High Hopes* NYTIMES.COM (Oct. 22 2014), http://www.nytimes.com/2014/10/23/business/media/taylor-swifts-1989-carries-high-hopes-but-no-country-music.html?_r=1&gwh=CB7004DC759B872E32B341E72C816DFB&gwt=pay&assetType=nyt_now; See also Swift, *supra* note 102.

124 Id.

125 Page, *supra* note 94, at 2.

126 *U.S. v. Colgate & Co.*, 250 U.S. 300 (1919).

127 See generally Part I and Part II

the exclusives are individually negotiated. As for duration, it is challenging to determine exactly when the duration changes from reasonable to unreasonable. The Billboard charts provide a source for a data driven approach to determining reasonable durations. The lists provide evidence of how long a song remains extremely popular. According to Billboard, in 2014 Pharell's "Happy" was the top Digital Song for nine weeks.[128] However, most songs throughout the year were the top song for only about one to three weeks.[129] This suggests that exclusives lasting for more than one month might generate concerns from an anticompetitive perspective. Another approach would be to look at the life cycle of music sales for a given song or album. If 90% of an album's total sales occur in one month, then an exclusive that extends much beyond that might suggest there are other anticompetitive motivating factors contributing to the arrangement besides a desire to increase sales.

As a single incident, the practice of granting a digital retailer an exclusive of a song or album for a specified period of time seems like a typical byproduct of a competitive market that would not violate Section 1 or 2 of the Sherman Act. Additionally, for a Section 2 claim, without a finding of market power, there is unlikely to be competitive harm. However, if multiple labels adopted windowing for entire catalogs of music or Apple facilitated coordination among record companies, these might be signs that the restraint is no longer reasonable under Section 1 or 2. Given the restrictive nature of windowing and the music industry's tendency to engage in anticompetitive behaviors, at some point a line must be drawn where windowing activity raises serious antitrust concerns. Condemning efficient activity involving intellectual

128 Digital Song Charts, BILLBOARD.COM, available at http://www.billboard.com/charts/digital-songs?order=timeon

129 Id.

property rights can undermine incentives to innovate resulting in economic growth, however failure to challenge exclusionary conduct can have negative consequences for consumers.[130]

In contrast, the bans on "free" streaming seems to raise much more serious antitrust concerns. As a potential means of eliminating a low-cost option for consumers, any such pressures should be subject to serious investigation, and if the conduct is identified, condemnation under one of the theories specified above.

Those in favor of an overhaul of the current music-licensing scheme seek a licensing framework that creates a "level playing field" for all music services where one service is not advantaged over another.[131] And yet, companies like Apple have pioneered windowed exclusives and advocated for the elimination of advertising based streaming. While Apple and record companies may publicly say the goals of these practices are to increase revenue, the industry is at risk of annihilating alternative legal competitors and contributing to a resurgence of piracy.

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130 U.S. Dep't of Justice and Federal Trade Commission, *supra* note 45, at 2.
131 Knife, *supra* note 23, at 1, 5.